An Overview of Input Tax Credit System and Computation of GST Liability

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Abstract

This paper attempts to study **Input credit computation** that means at the time of paying tax on output, one can reduce the tax that have already paid on inputs. Input tax Credit (ITC) is a major element of understanding which has various implications under GST. In changing scenario, the government keeps on making various amendments to the GST Law. There are different rules defined under GST Law in relation to ITC for all categories of taxpayers. Goods and Services Tax (GST) would mitigate such cascading of taxes. Under this new system most of the indirect taxes levied by Central and the State Governments on supply of goods or services or both would be combined together under a single levy. Input credit means at the time of paying tax on output, you can reduce the tax you have already paid on inputs. Input tax credit in realtion to GST to a registered person means, the CGST, SGST/UTGST or IGST charged on any supply of goods or services or both made to him. It includes IGST charged on imports & tax payable under reverse charge mechanism. There are other imporatant pointers which needs to be kept in mind while claiming provisional credit like the 10 % will be of total eligible ITC from all suppliers based on details uploaded in the GSTR-2A, a taxpayer can avail full ITC in terms of IGST paid on imports, credit that has been received from an Input Service Distributor (ISD), credit from documents received under reverse charge mechanism and any other such credit, etc.

The term 'Inverted Tax Structure' refers to a situation where the rate of tax on inputs purchased (i.e.GST Rate paid on inputs received) is more than the rate of tax (i.e. GST Rate Payable on outward supplies) on outward supplies. In case of inverted duty structure the taxpayer can claim refund of excess ITC available. Normally, there should always be a liability to pay GST due to value addition made by the taxable person. However, due to multiple tax rates, despite value addition, there might arise a situation that there is accumulation of input tax credit wherein GST rate on inputs is higher than the GST rate on outputs which is termed as Inverted Duty Structure. The few industries facing this issue are utensils, e – rickshaw, non woven fabric bags, textile industry, etc. No refund of the unutilized input tax credit shall be allowed in case of a supply of Construction Services.

Key words: GST, Goods and services tax, Indian Tax, ITC

Introduction

"Input Tax" means the GST Taxes (CGST, SGST, IGST) charged on any supply of goods or services or both made to a registered person in the course or furtherance of his business and includes such tax payable on reverse charge basis— but excludes tax paid under composition levy. Every registered person shall be entitled to take credit of input tax charged on any supply of goods or services to him which are used or intended to be used in the course or furtherance of his business on the basis of any of the following tax-paying documents:

1. Tax Invoice issued
2. Debit note
3. Bill of entry
4. Invoice prepared in respect of reverse charge basis
5. Document issued by Input Service Distributor for distribution of credit.

Catch Point: It is important to observe the words 'used by him' and 'in his business'. These words refer to the registered taxable person in question and not the legal entity as a whole. So, ITC paid in a State MUST NOT be in relation to the business of a taxable person in another State even if belonging to the same taxable person. In following cases no refund of the unutilized input tax credit shall be allowed:

- If output supplies are nil rated or fully exempt supplies.
- If supplier claims refund of output tax paid under IGST Act
- If the goods are exported out of India are subject to export duty.
- If the supplier of goods or services or both avails of drawback in respect if the central tax or claims a refund of IGST on such supplies.

With retrospective effect from 1st July 2017 ,refund is allowed only for the inputs of goods. Input doesn't include input services and capital goods for this purpose. Net ITC includes ITC of all inputs whether or not used directly consumed in the manufacturing process. An input tax credit of the GST paid on inputs shall be available to a registered person as long as he/she uses or intends to use such inputs for the purposes of his/her business and there is no specific restriction on the availment of such ITC and thus ITC on stores and spares, packing materials, materials purchased for machinery repairs, printing and stationery items are thus included in Net ITC for calculation of refund.

Maximum Refund Amount = (Turnover of inverted rated supply of goods and services X Net input tax credit / Adjusted total turnover) – Tax payable on such inverted rated supply of goods and services.

The terms in the above formula have been specfically stated and defined.

For claiming refund there are various conditions like :

1. GSTR 1 and GSTR-3B has to be filed for the relevant tax period for which you want to file refund application of the accumulated ITC.

2. RFD-01A is similar to RFD-01 which is introduced as a temporary solution for application till such time the online facility is enabled for claims of refund.

3. RFD-01A has to be filed within 2 years from the end of financial year in which such claim for refund arises. The taxpayer ie the principal is allowed to take ITC of the goods or capital goods sent to a job worker for job work. Input is allowed even if the inputs are directly sent to a job worker for job-work without their being first brought to his place of business. If such goods are not received back by principal or supplied from place of job worker within one year from the date of sending goods to job worker or three years from the date of sending capital goods to job worker, then it shall be deemed that such inputs had been supplied by the principal to the job-worker on the day when the said inputs were sent out .

This rule of deemed supply shall not apply to moulds and dies, jigs and fixtures, or tools sent out to a job-worker for job-work.

ITC need not to be reversed even if waste is not returned by job worker but no ITC can be availed on short supply of input received.

The ISD issues of a document called an ISD invoice containing the amount of input tax credit and distributes the credit to the branches (having the same PAN) on a proportional basis in the ratio of the turnover of all such recipients that are operational during the year .The tax credit available against any specific input services used entirely by one of the recipients can be allocated only to that recipient for utilization of such credit and not to other recipients. No differentiation is made to whether the unit is registered or not, and therefore, credit attributable to the unregistered unit is distributed to that unit which implies, it is a loss of credit. For this Input Service Distributor has to compulsorily register as “ISD” apart from its registration as a normal taxpayer under the Act. ISD cannot distribute credit on inputs (eg: raw materials and capital goods) and to outsourced manufacturers or service providers.

The credit of tax paid under reverse charge mechanism is not available for distribution to the recipients. So, the ISD has to utilize such credit only as a normal taxpayer.

Banks, financial institutions and non banking financial companies (NBFC) have an option to avail an amount equal to 50 per cent of the eligible input tax credit on inputs, capital goods and input services in that month or to take input tax credit only on purchases made for selling taxable or zero rated goods or services and leave out the tax paid on purchases made for exempted supplies. Option once exercised can not be changes during the financial year. Also restriction of 50% doesn’t apply where the tax is paid on supply from one registered person to another registered person having the same Permanent Account Number.

When the bank, financial instition or NBFC opts to pay for 50 % then the restriction of 50% shall not apply to the tax paid on supplies made by one registered person to another registered person having the same Permanent Account Number.

There is a special provision made under the act for availing input tax credit in case of pipelines and telecommunication tower fixed to earth by foundation or structural support. The input tax credit shall not exceed:

– $1/3^{rd}$of the total ITC in the financial year in which the said goods are received

– $2/3^{rd}$of the total ITC, including the credit availed in the first financial year, in the financial year immediately succeeding the year referred to above in which the said goods are received,

– the balance of the amount of credit in any subsequent financial year.

Objective:

This paper intends to explore and analyze **Input Tax Credit computation** claiming the credit of the GST paid on purchase of Goods and Services which are used for the **furtherance of business**.

Input Tax Credit (ITC) heart of Goods and Services Tax

Goods and Services Tax (GST) is considered the biggest reforms in India. However, one thing that has become the talking point is – the mechanism of input credit under GST.

In simple words, Input Credit means at the time of paying tax on sales, you can reduce the tax you have already paid on purchases.

In this article, we'll cover all you need to know about Input Tax Credit (ITC) under GST, the time limit to avail ITC, how to calculate Input Tax Credit, how to claim ITC, the situation where you can not avail ITC and much more.

Input Tax Credit means reducing the taxes paid on inputs from taxes to be paid on output. When any supply of services or goods is supplied to a taxable person, the GST charged is known as Input Tax.

The concept is not entirely new as it already existed under the pre-GST indirect taxes regime (service tax, VAT and excise duty). Now its scope has been widened under GST.

Earlier, it was not possible to claim input tax credit for Central Sales Tax, Entry Tax, Luxury Tax and other taxes. In addition, manufacturers and service providers could not claim the Central Excise duty.

During the pre-GST era, cross-credit of VAT against service tax/excise or vice versa was not allowed. But under GST, since these taxes will be subsumed into one tax, there will not be the restriction of setting off this input tax credit.

The conditions to claim Input Tax Credit under GST is a very critical activity for every business to settle the tax liability.

Input Tax Credit can't be applied to all type of inputs, each state or a country can have different rules and regulations. Input Tax Credit is also viable to a dealer who has purchased good to resale.

Tax Credit is the backbone of GST and for registered persons is a major matter of concern. This is majorly in line with the pre-GST regime. These rules are quite stringent and particular in their approach.

Say for instance that you are a manufacturer. The tax to be paid on the final product is INR 450. The purchase tax paid is INR 300. The input credit you claim is INR 300, and the final taxes you will pay is INR 150.

Time, limit to avail GST ITC

ITC can be availed by a registered taxable person in a specific manner and within a specified time frame. The table below shows the different situations wherein the inputs can be claimed for semi-finished goods or stock or finished goods.

Situation	**ITC claims day for semi-furnished goods/stock/finished goods (held on immediate preceding day)**
If a person has applied for registration or is liable to register or is granted registration	Day from when he is liable to pay taxes
When a person takes voluntary registration	Registration day
When a taxable registered person stops paying taxes in composition levy scheme	Day from when he is liable to pay tax normally u/s 7.

Input tax credit for the above-mentioned situations can be claimed only if it does not exceed one year from the tax invoice date of issue related to supply.

For any other cases, ITC must be claimed earlier of the following-

a) Furnishing of annual return or

b) Due date of filing the monthly return (GSTR-3) for the next financial year's September month.

How to claim Input Tax Credit (ITC)?

The following conditions have to be met to be entitled to Input Tax Credit under the GST scheme:

1. One must be a registered taxable person.
2. One can claim Input Tax Credit only if the goods and services received is used for business purposes.
3. Input Tax Credit can be claimed on exports/zero-rated supplies and are taxable.
4. For a registered taxable person, if the constitution changes due to merger, sale or transfer of business, then the Input Tax Credit which is unused shall be transferred to the merged, sold or transferred business.
5. One can credit the Input Tax Credit in his Electronic Credit Ledger in a provisional manner on the common portal as prescribed in model GST law.
6. Supporting documents – debit note, tax invoice, supplementary invoice, are needed to claim the Input Tax Credit.
7. If there is an actual receipt of goods and services, an Input Tax Credit can be claimed.
8. The Input Tax should be paid through Electronic Credit/Cash ledger.
9. All GST returns such as GST-1, 2,3, 6, and 7 needs to be filed

e.g: How Input Tax Works Under GST

Suppose Mr. A is a seller. He sells goods to Mr. B. The buyer Mr. B is now eligible to claim the purchase credit using his purchase invoices.

This is how it works:

1. A uploads all his tax invoices details as issued in GSTR-1.
2. The details uploaded by Mr. A is automatically populated or reflected in GSTR-2A. This same data will get reflected when Mr. B files the GSTR-2 returns which are nothing but the details of his purchase.
3. The details of thesale are then accepted and acknowledged for by Mr. B, and subsequently, the purchase tax is credited to Mr. B's 'Electronic Credit ' He can use this to adjust it later for future output tax liability and receive a refund.

To utilize the Input tax credit

In GST we have three types of taxes CGST, IGST, and SGST/UTGST. For the inter-state supply of goods/ services, IGST is charged. and for the intra-state supply of goods/services CGST and SGST/UTGST are charged.

While making payment for the above taxes, input tax credit will be allowed in the following manner-

Credit	1st to be utilized for payment of	Balance if any
CGST	CGST	IGST
IGST	IGST	CGST and then SGST/UTGST
SGST/UTGST	SGST/UTGST	IGST

Each applicant will require the following documents to claim Input Tax Credit under GST:

1. Supplier issued invoice for supplying the services and goods or both according to GST law.
2. A debit note issued by the supplier to the recipient in case of tax payable or taxable value as specified in the invoice is less than the tax payable or taxable value on such supplies.
3. Bill of entry.
4. A credit note or invoice which is to be issued by the ISD (Input Service Distributor) according to the GST invoice rules.
5. An invoice issued like the bill of supply under certain situations instead of the tax invoice. If the amount is lesser than INR 200 or in conditions where the reverse charges are applicable according to the GST law.
6. A supplier issued a bill of supply for goods and services or both as per the GST invoice rules.

The above documents prepared as per the GST invoice rules should be furnished while filing the GSTR-2 form. Failure to present these forms can lead to either rejection or resubmission of the request.

For taxes paid on goods and services or both due to any fraud or due to order for the demand raised, suppression of facts or wilful misstatement, Input Tax Credit cannot be claimed.

Since input credit will be available to the seller at each stage, the input tax credit is expected to bring down the overall taxes charged on the product at present. So, if input credit mechanism works efficiently, final consumers may see the cost reduction.

Conclusion

Uninterrupted and seamless chain of input tax credit is one of the key features of Goods and Services Tax. ITC is a mechanism to avoid cascading of taxes. Cascading of taxes, in simple language, is 'tax on tax'. Under the present system of taxation, credit of taxes being levied by Central Government is not available as set-off for payment of taxes levied by State Governments, and vice versa. One of the most important features of the GST system is that the entire supply chain would be subject to GST to be levied by Central and State Government concurrently. As the tax charged by the Central or the State Governments would be part of the same tax regime, credit of tax paid at every stage would be available as set-off for payment of tax at every subsequent stage. Central excise duty charged on inputs used for manufacture of final product can be availed as credit for payment of Central Excise Duty on the final product.

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